



# **National Economic Outlook**

## *MSBO Financial Strategies Conference*

**January 17, 2018**

**Presented by:**

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# Agenda

## REVIEW

Where are we today and how have capital markets reacted?

## OUTLOOK

What is the Federal Reserve telling us?

## KEY TRENDS

What are we watching?

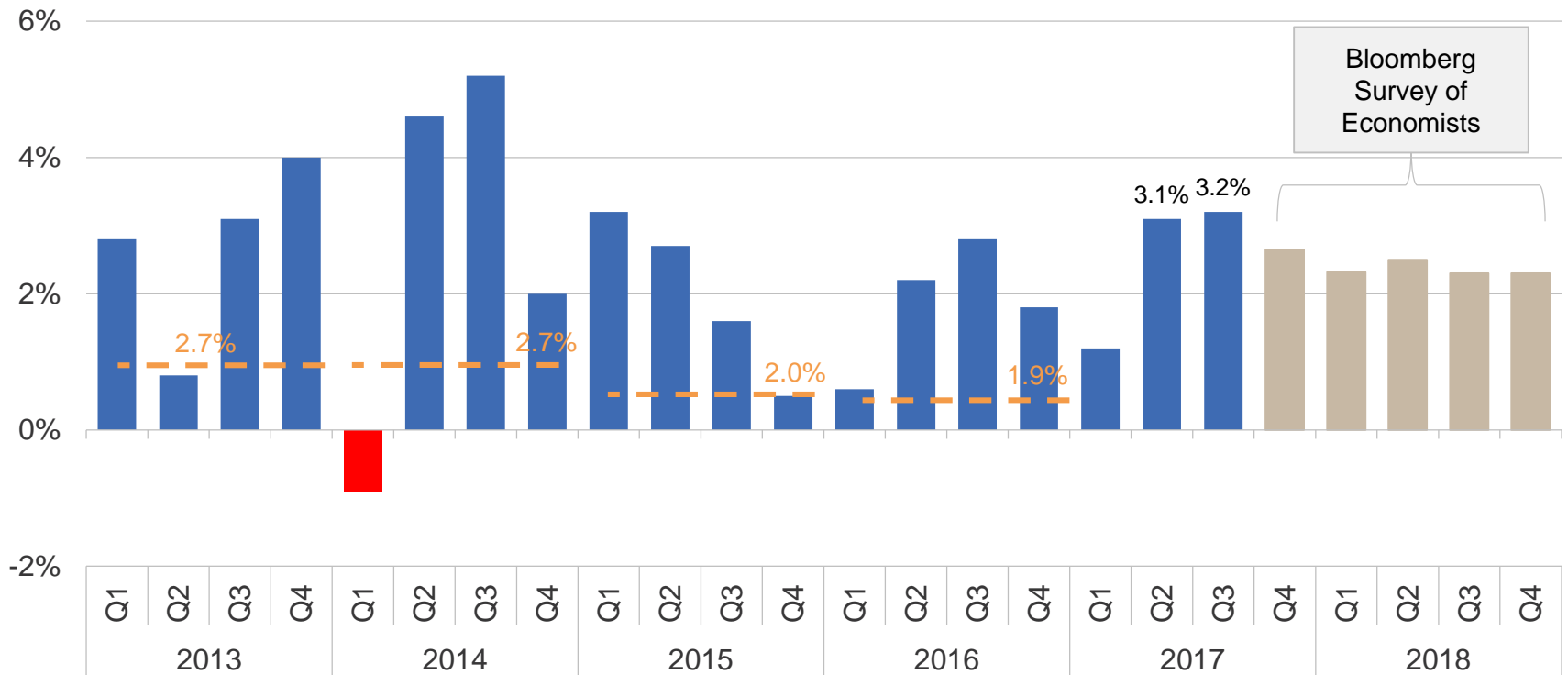


**Where are we today and  
how have capital markets reacted?**



## Economic Growth Remains Strong

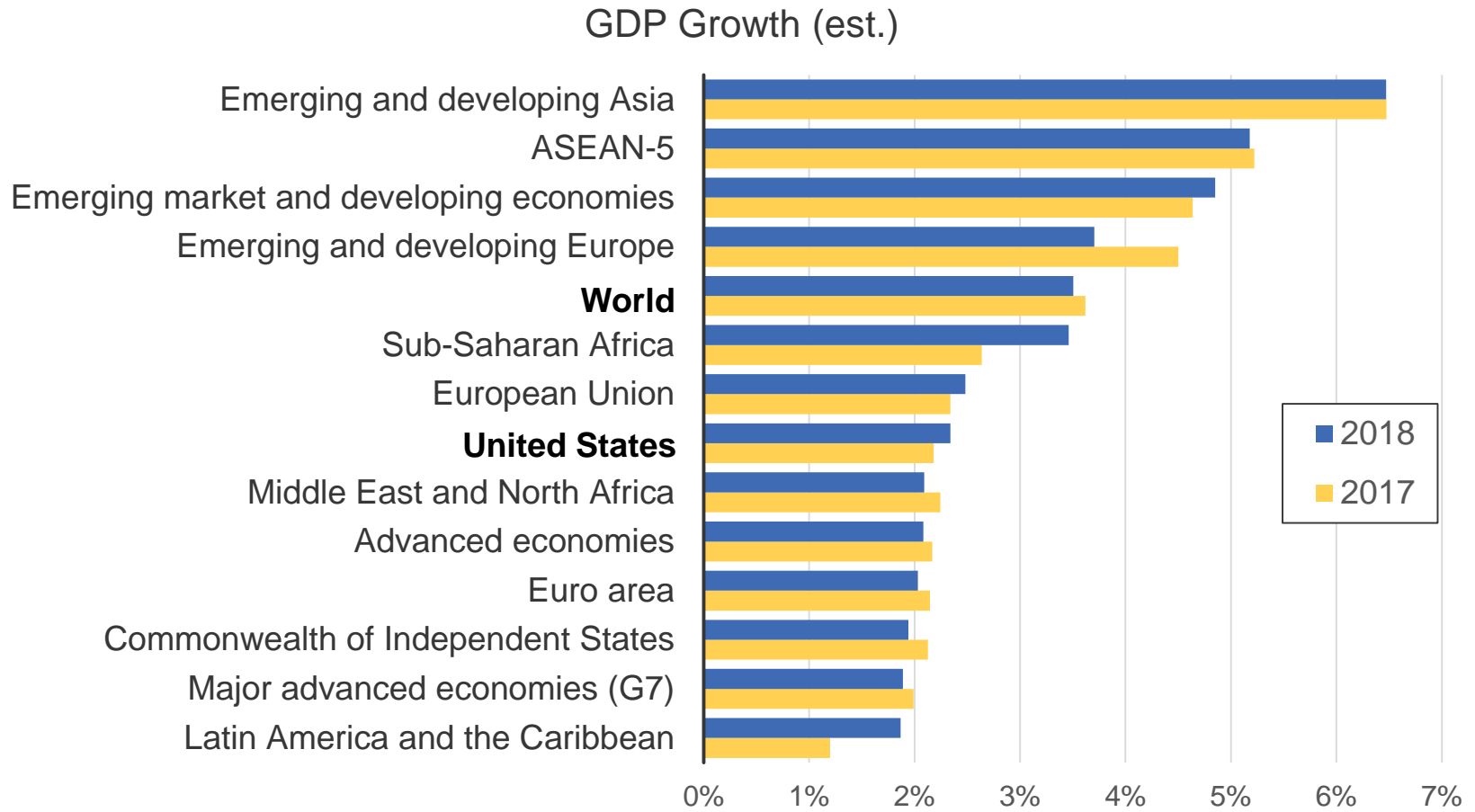
U.S. Real GDP  
QoQ, SAAR



Source: Bloomberg, as of Q3 2017. SAAR is seasonally adjusted annualized rate. Orange denotes rolling four-quarter averages.



## Synchronized Global Growth Across All World Regions

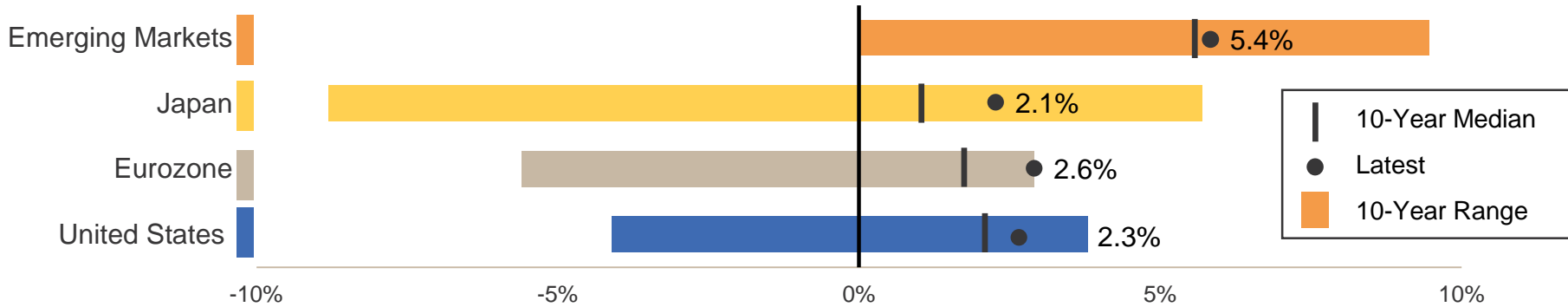


Source: IMF World Economic Outlook, as of October 2017

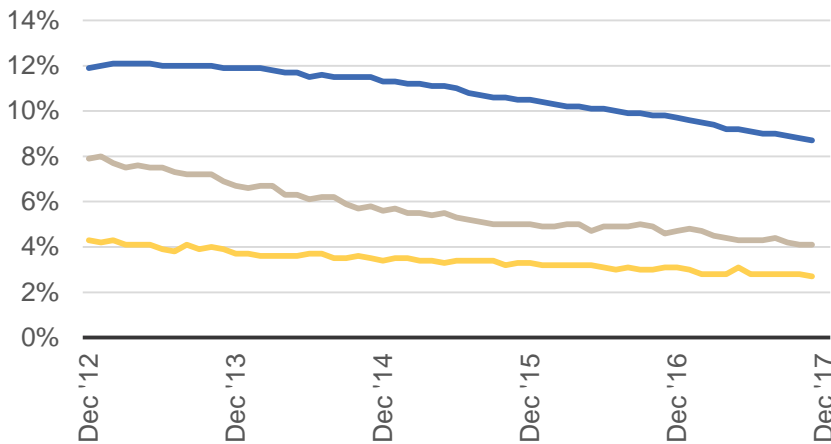


# Global Macroeconomic Scorecard

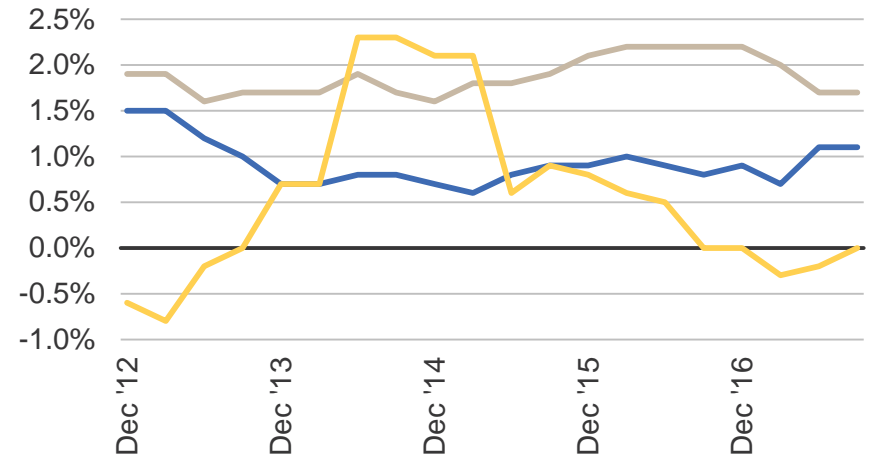
## Gross Domestic Product (GDP) Growth



## Unemployment Rate



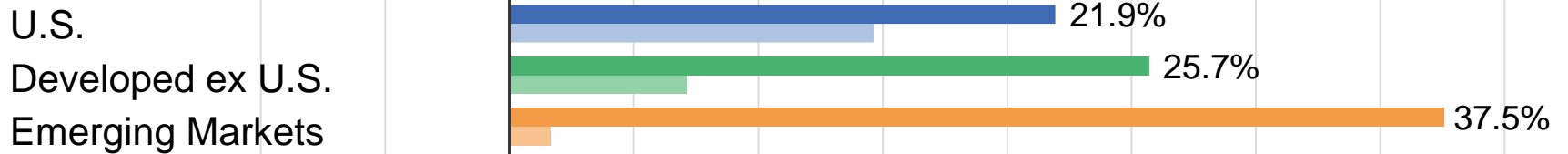
## Inflation (Core CPI, YoY)



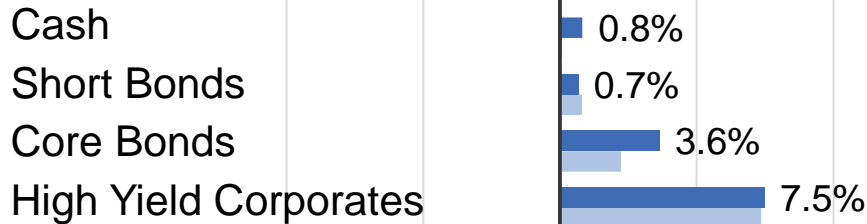


## 2017 Asset Class Returns

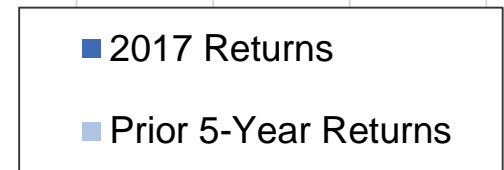
### Equities



### Domestic Fixed Income



### Alternatives



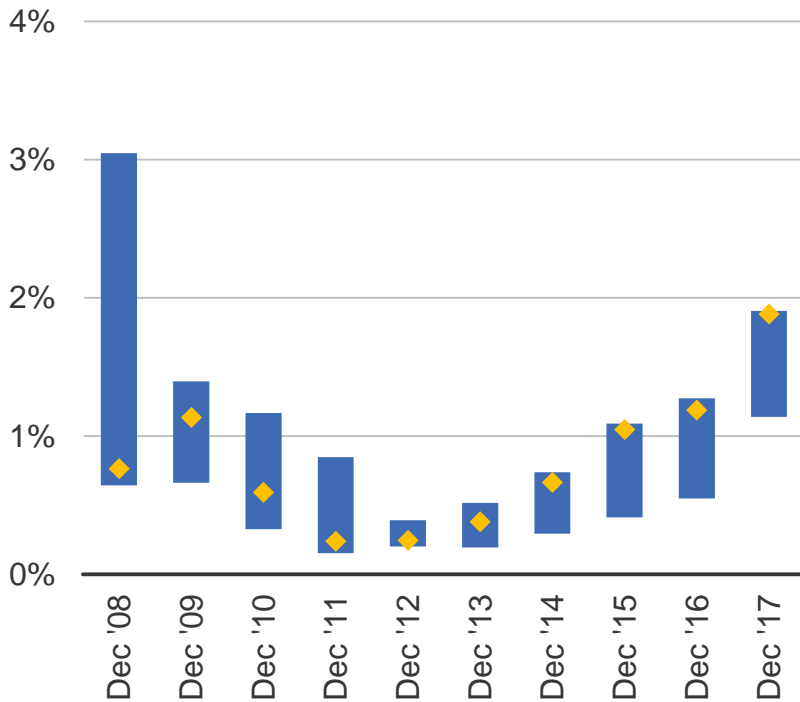
-10% -5% 0% 5% 10% 15% 20% 25% 30% 35% 40%

Prior 5-Year Returns are based on time period from December 31, 2011 to December 31, 2016, and are annualized.

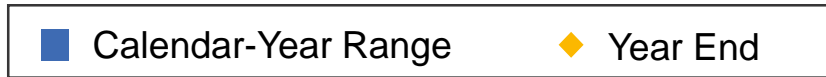
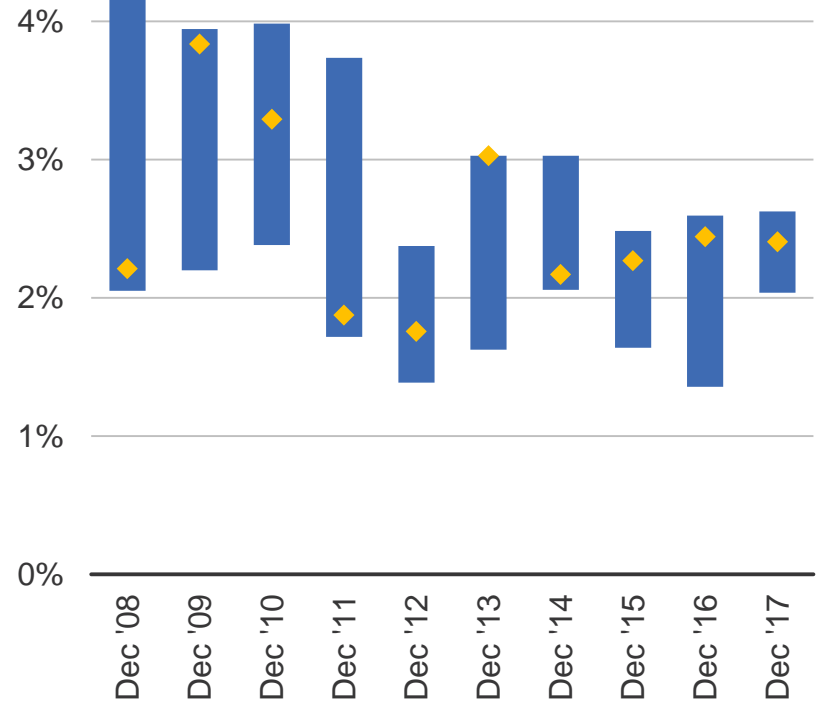


# Treasury Yields Range-Bound Amid Low Volatility

### U.S. 2-Year Treasury Yield



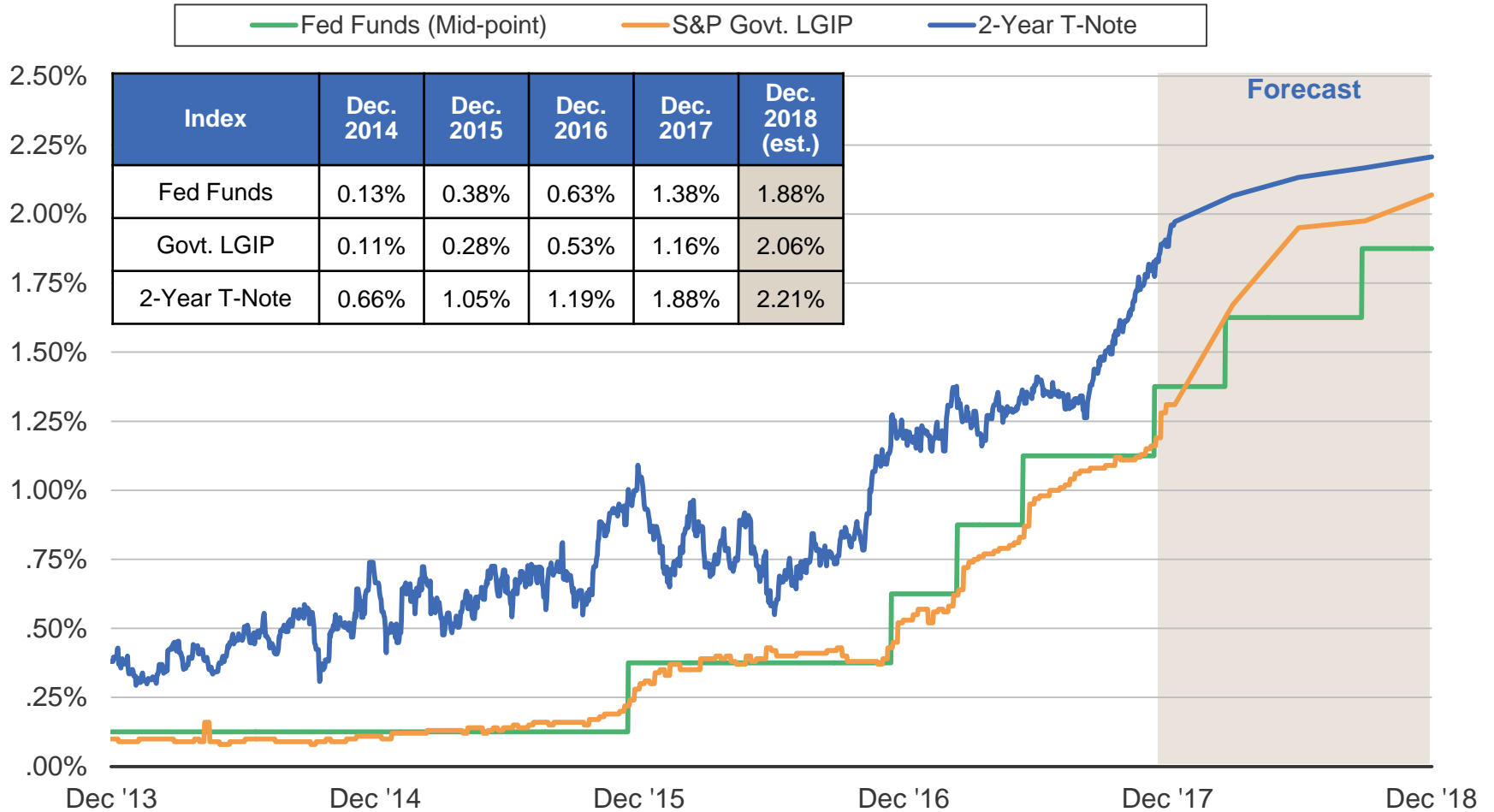
### U.S. 10-Year Treasury Yield







# Cash Yields Signal End of Financial Repression



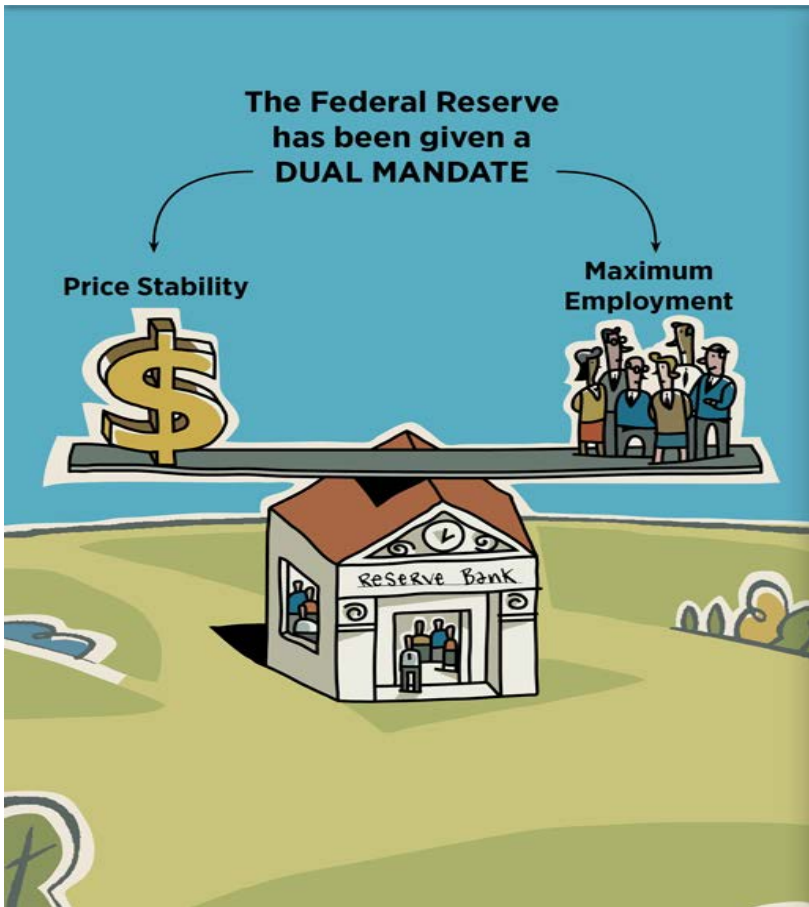
Fed Funds rate shown is the mid point of the target range. Fed Funds rate forecast is based on the Fed Funds futures. 3-month T-Bill and 2-Year T-Note forecast is based forward rates. Government LGIP forecast is based on historical 1-Year moving average spread over 3-month T-Bill forward rate.



**What is the Federal Reserve telling us?**



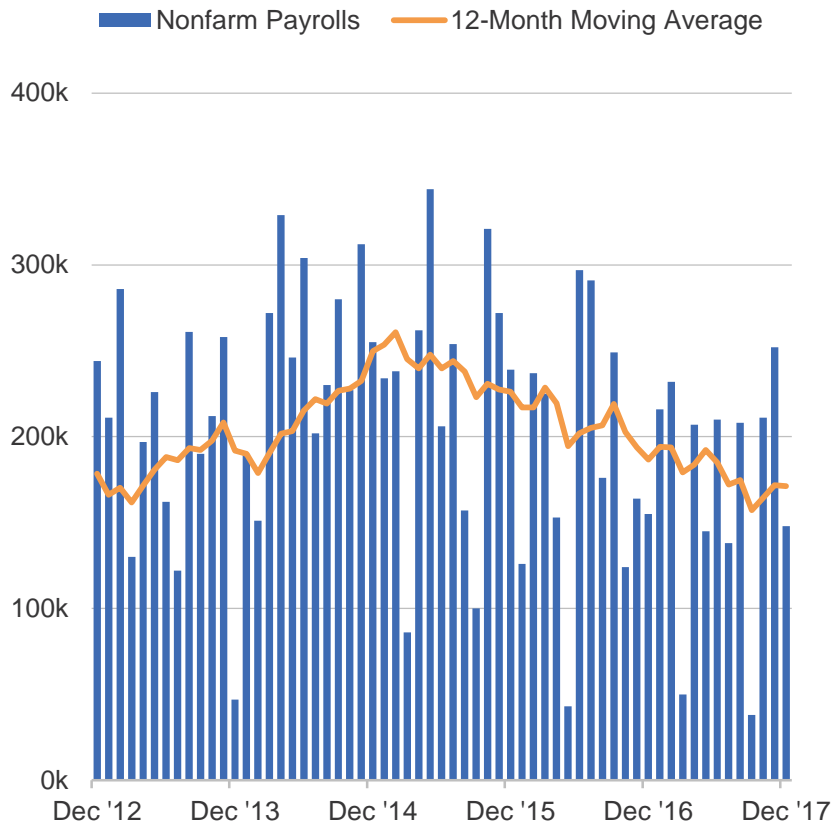
## Dual Mandate... Dueling Mandates



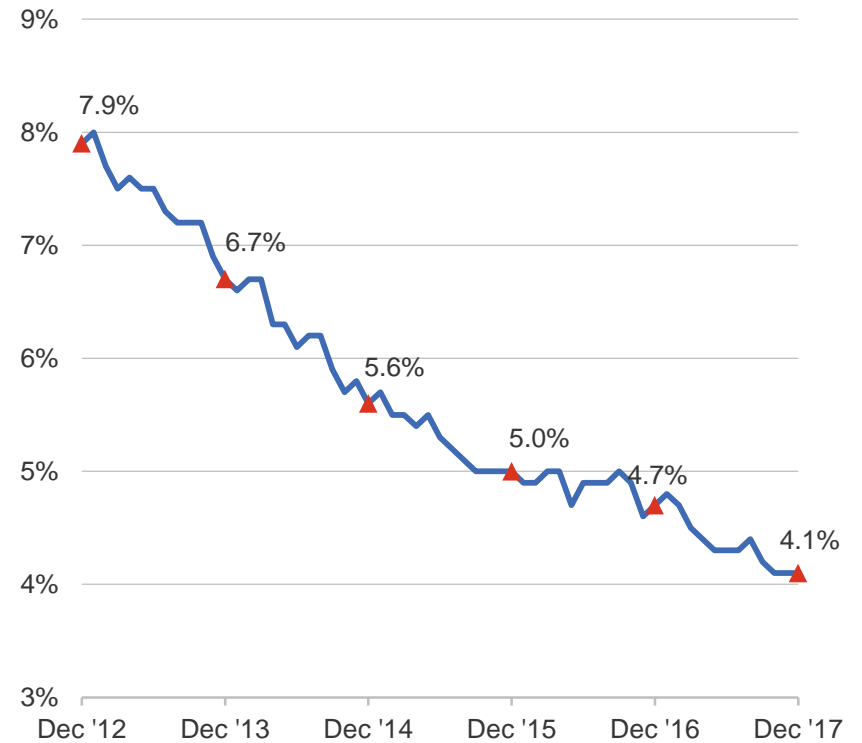


# Labor Market Activity Slows as Expected

## Monthly Change in Nonfarm Payrolls



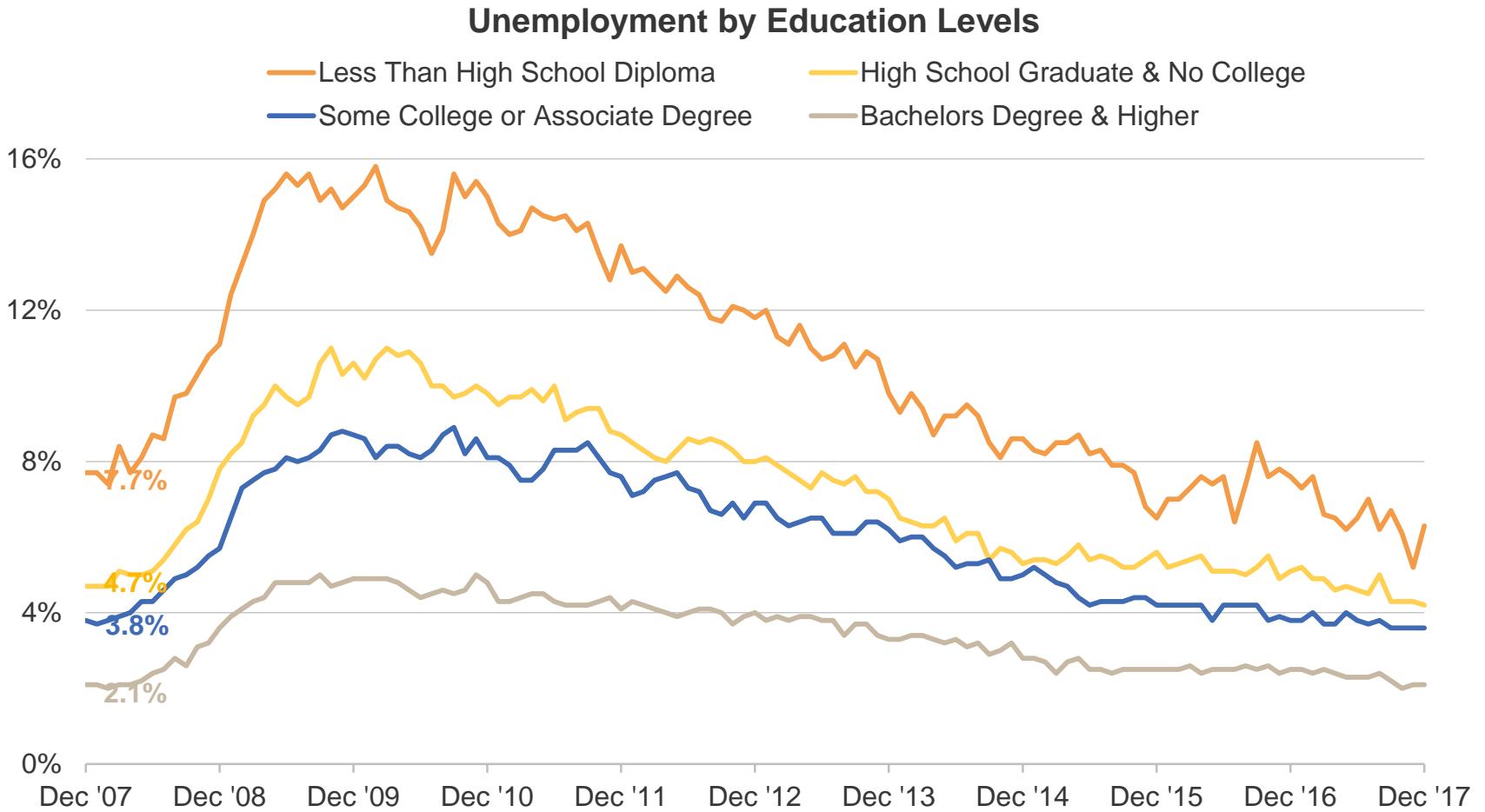
## Unemployment Rate



Source: Bloomberg, as of December 2017.



## Unemployment by Education Levels

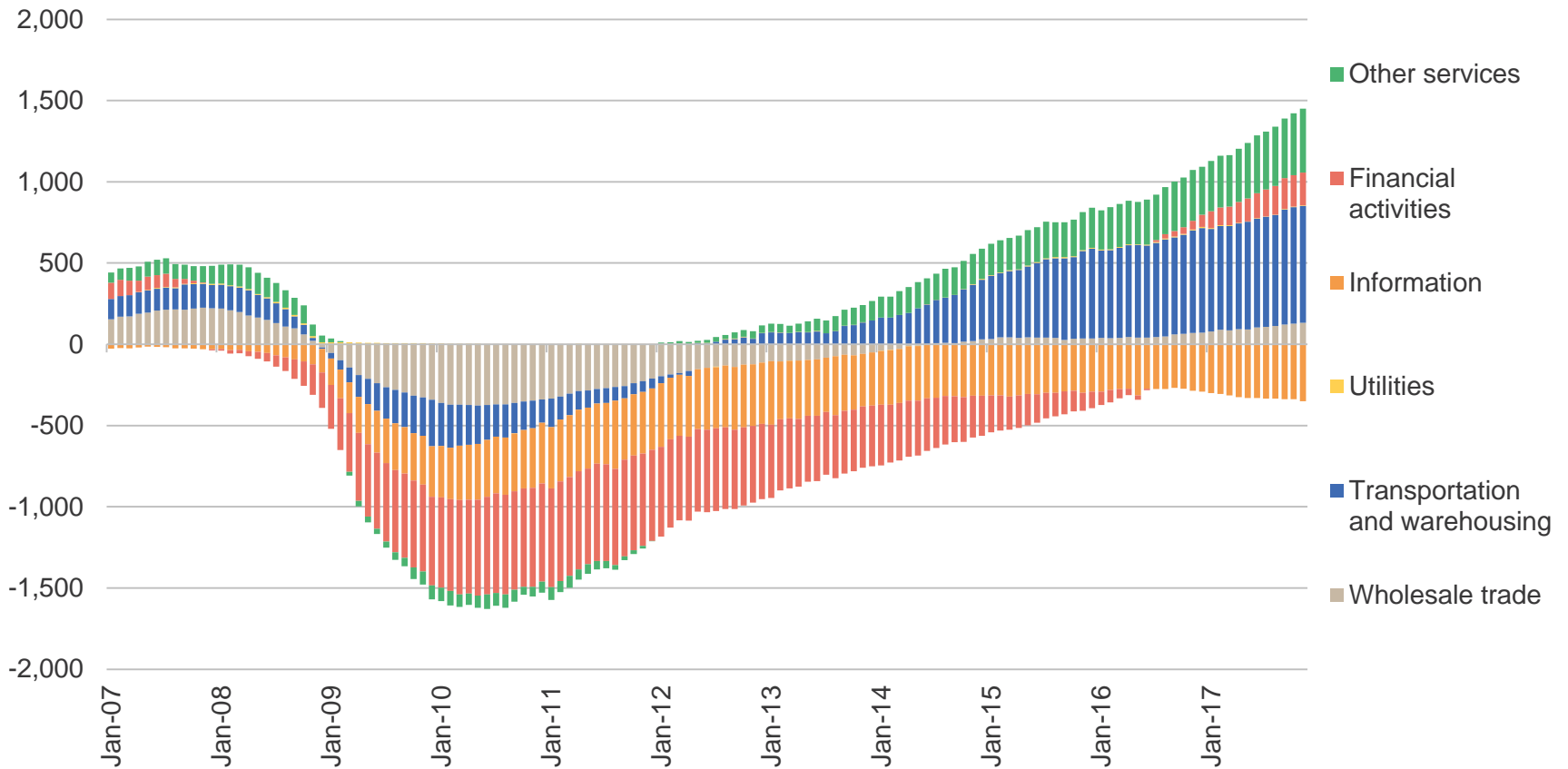


Source: Bloomberg, most recent data as of December, 2017.



# Services Sector Employment Trends

## Cumulative Change in Employment (Thousands)

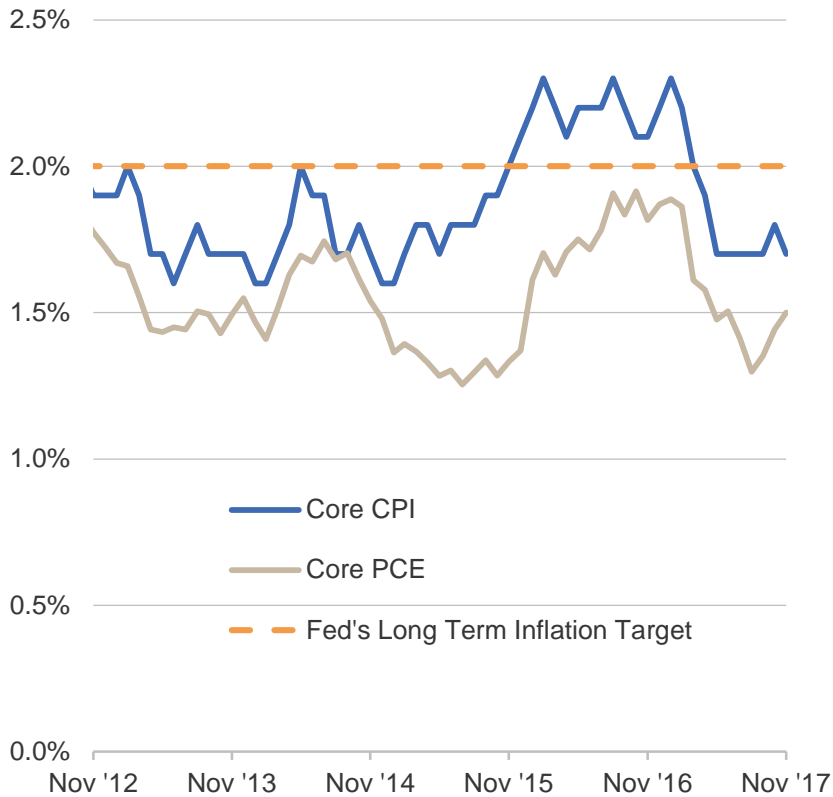


Source: Bureau of Labor Statistics, most recent data available as of November 2017.



# Inflation Steadies, but Outlook Remains Weak

### Inflation Measures (YoY)



### Expectations for Average Inflation Rate over next 5 years



Source: Bloomberg, latest data available as of December 2017. Inflation expectations based on yield difference between 5-year Treasury note and 5-year Treasury Inflation Protected Securities (TIPS).



## The Fed's Updated Economic Projections Are Optimistic

Indicator	2017		2018		2019		2020		Longer run	
	Sep.	Dec.	Sep.	Dec.	Sep.	Dec.	Sep.	Dec.	Sep.	Dec.
Real GDP (YoY)	2.4%	2.5%	2.1%	2.5%	2.0%	2.1%	1.8%	2.0%	1.8%	1.8%
Unemployment Rate	4.3%	4.1%	4.1%	3.9%	4.1%	3.9%	4.2%	4.0%	4.6%	4.6%
PCE Inflation (YoY)	1.6%	1.7%	1.9%	1.9%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%
Core PCE (YoY)	1.5%	1.5%	1.9%	1.9%	2.0%	2.0%	2.0%	2.0%	-	-
Federal Funds Rate (Median)	1.4%	1.4%	2.1%	2.1%	2.7%	2.7%	2.9%	3.1%	2.8%	2.8%

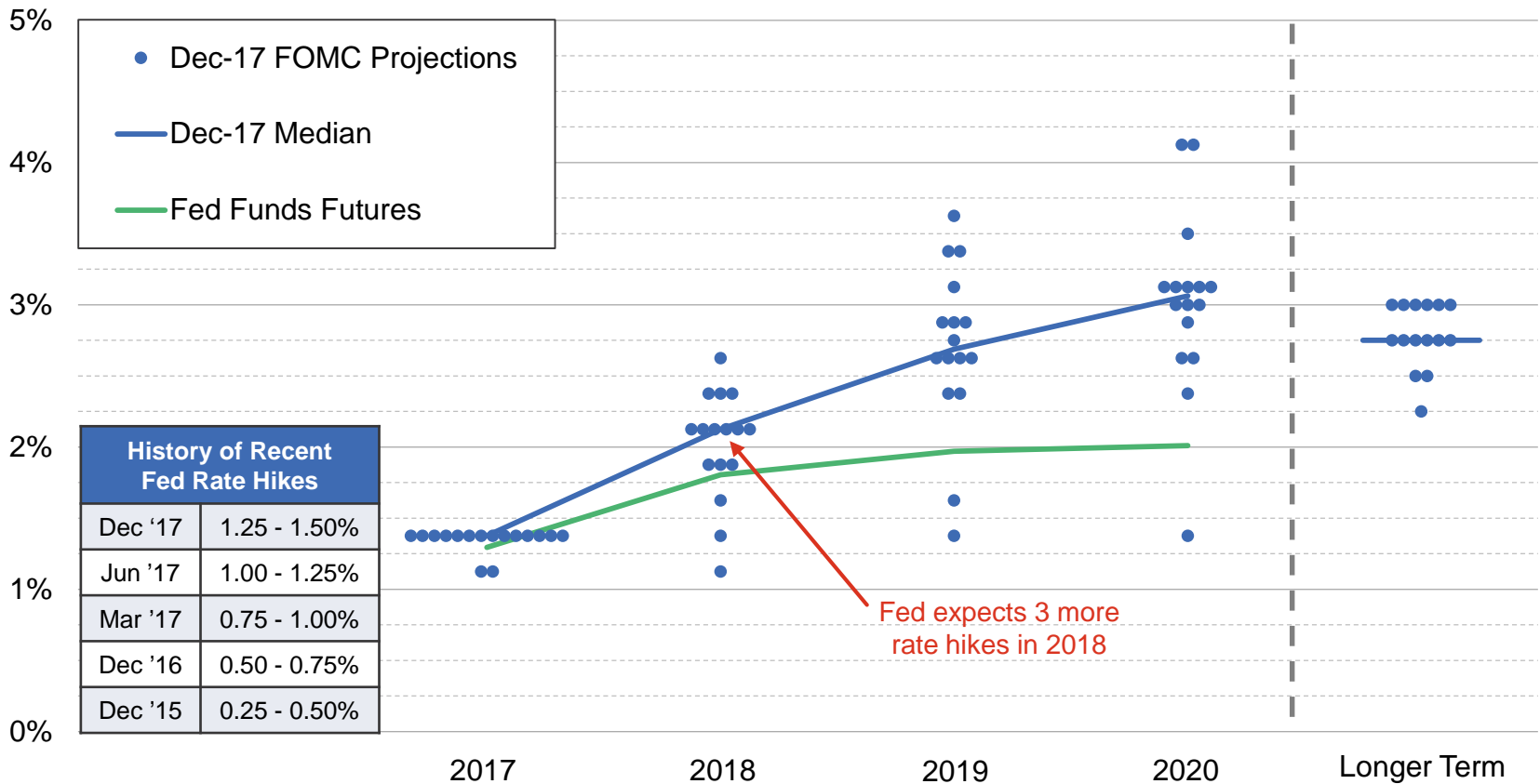
Source: Federal Reserve, as of December 2017. Green denotes an improved projection in December compared to September, red for lower projection.





# FOMC “Dot Plot” – December 2017

## Fed Participants’ Assessments of ‘Appropriate’ Monetary Policy

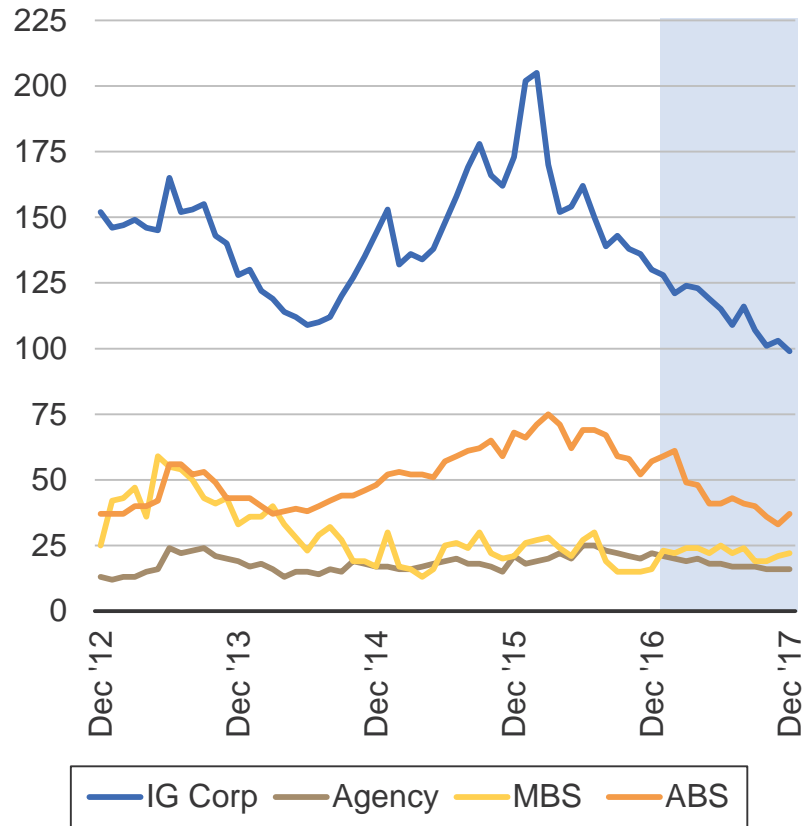


Source: Federal Reserve and Bloomberg. Individual dots represent each Fed members’ judgement of the midpoint of the appropriate target range for the federal funds rate at each year-end. Fed funds futures as of 12/13/17.

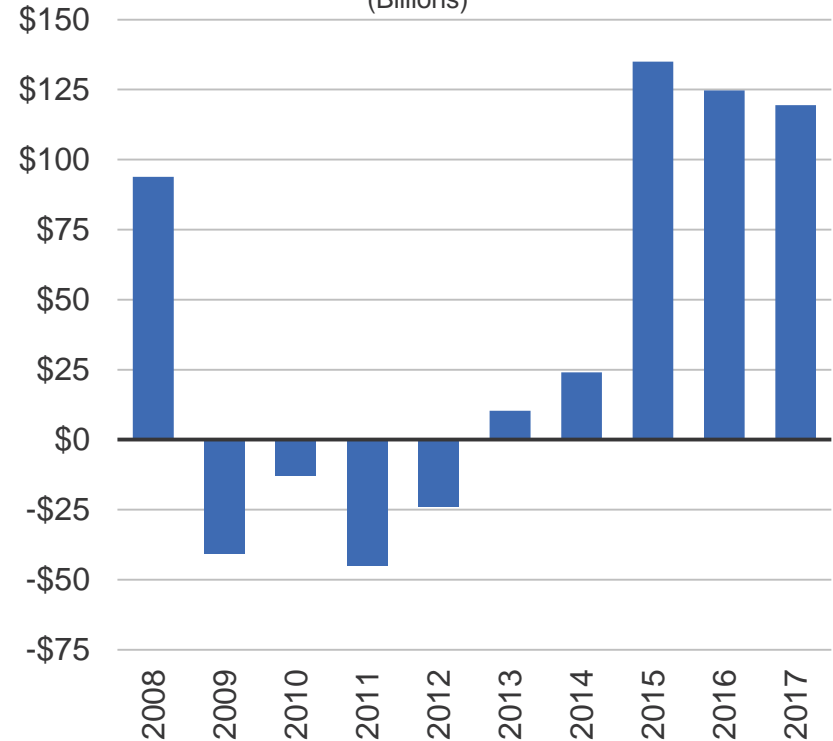


## Spreads Narrow Across Sectors

### Yield Spreads (basis points)



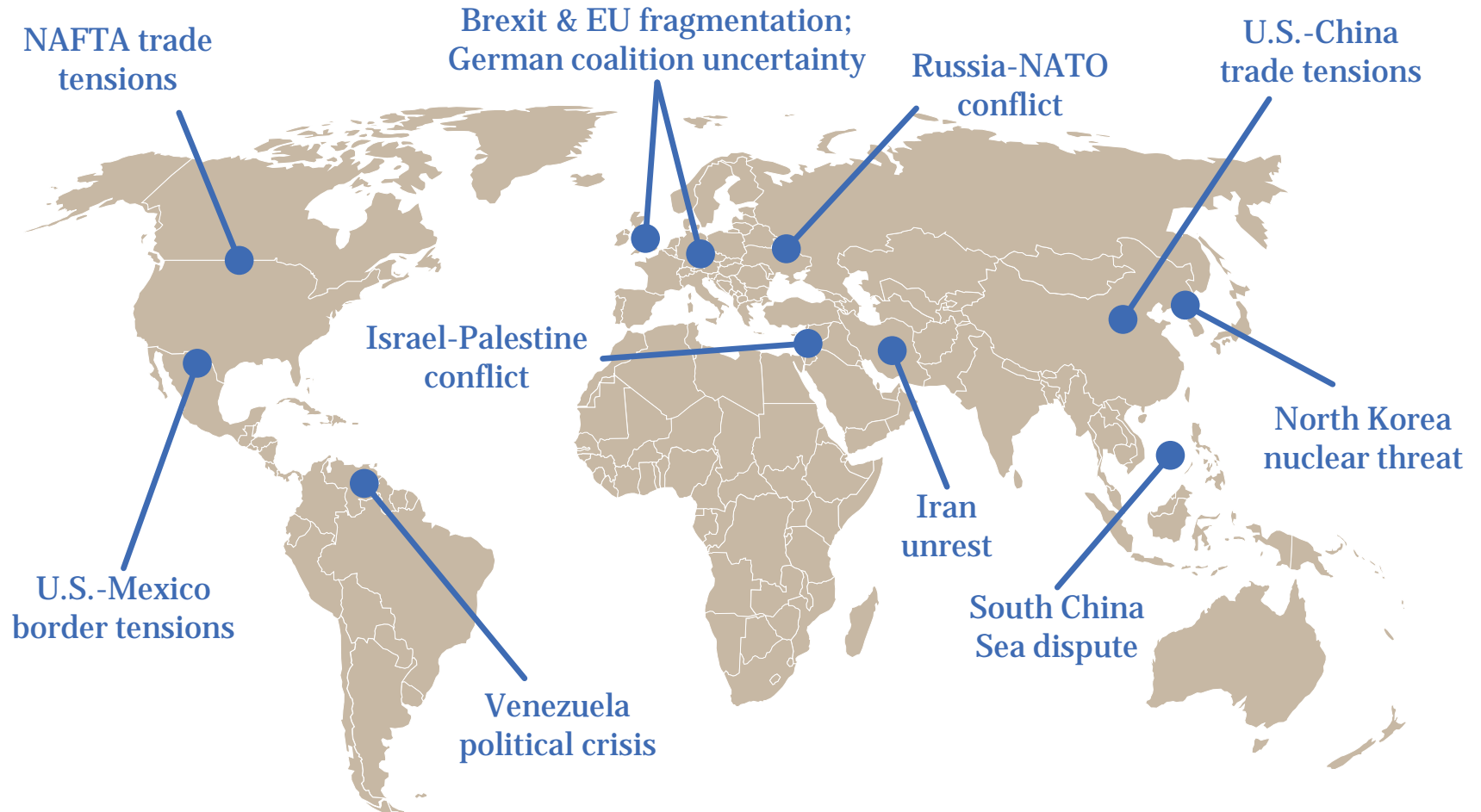
### Net Foreign Purchases of U.S. Corporate Debt (Billions)



Yield spreads represent option-adjusted spreads. Foreign purchases of U.S. corporate bonds only include the major foreign buyers, namely official institutions, and international and regional organizations as classified by the U.S. Department of the Treasury.



## Geopolitical Risks Around the Globe





**What are we watching?**



## Impact of Tax Cuts



### Short Term

Boost in corporate profits and consumer spending



### Next 10+ Years

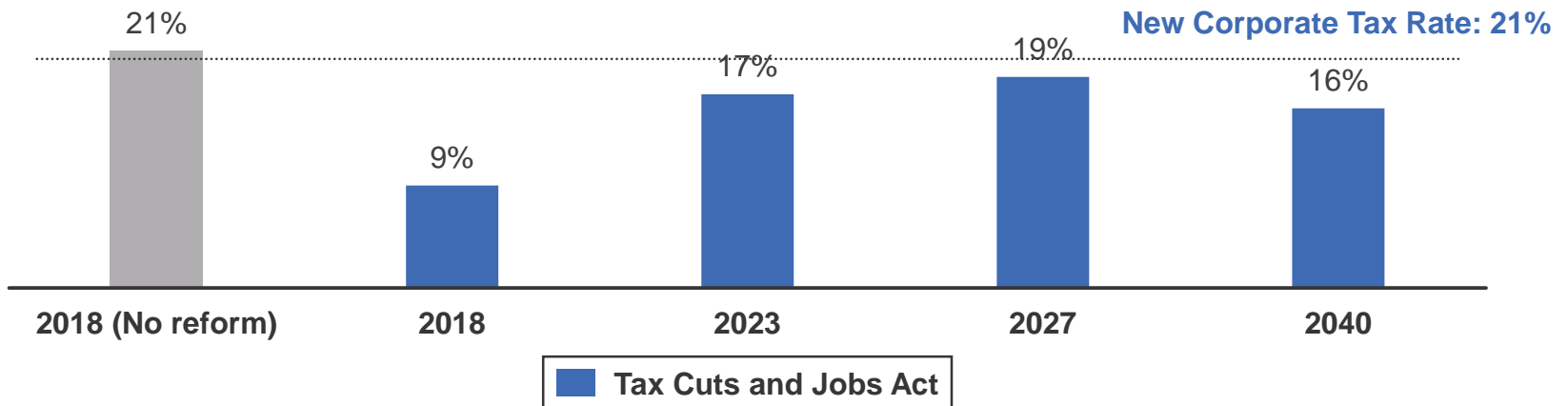
Increased uncertainty due to sunset provisions



### Long Term

Potential economic impact from business investment

Expected Average Effective Tax Rate for the U.S. Corporate Sector



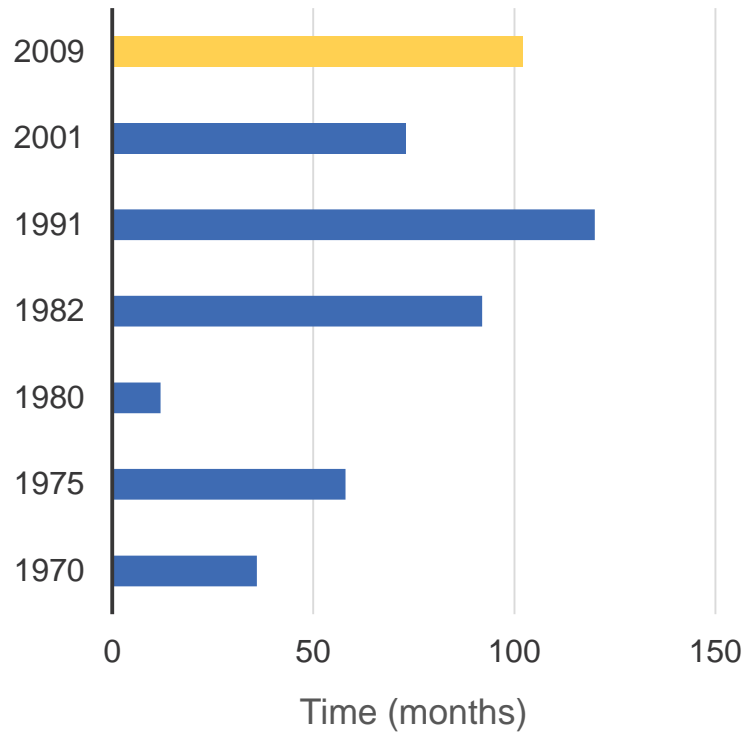
Source: Penn Wharton Budget Model, as of December 15, 2017.

<http://budgetmodel.wharton.upenn.edu/issues/2017/12/15/effective-tax-rates-by-industry>

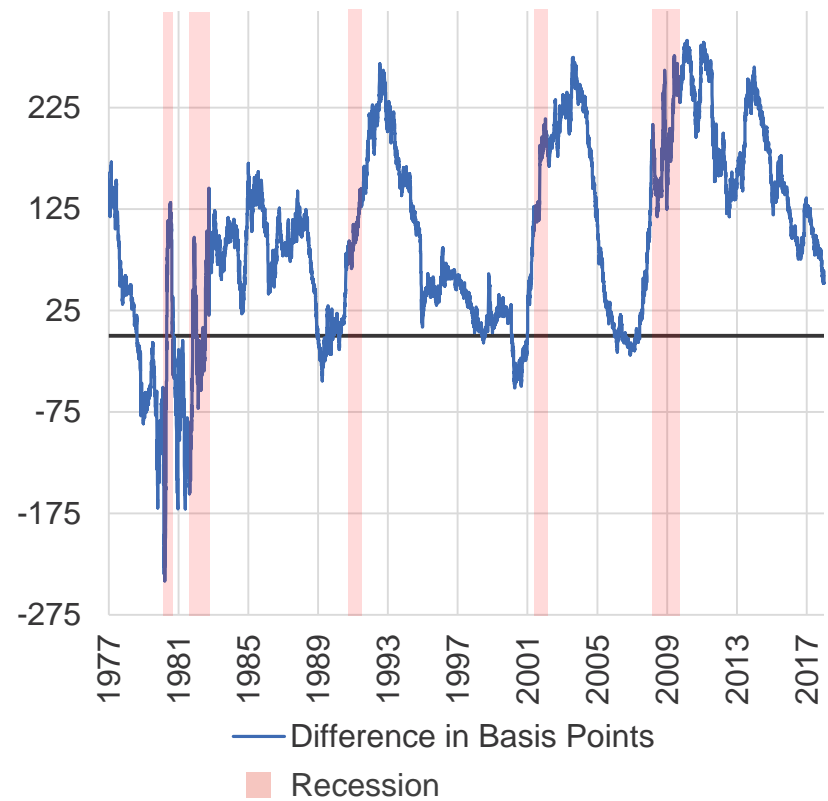


# Business Cycle Risk

### Duration of U.S. Expansion Periods



### 10-Year/2-Year Treasury Yield Spread

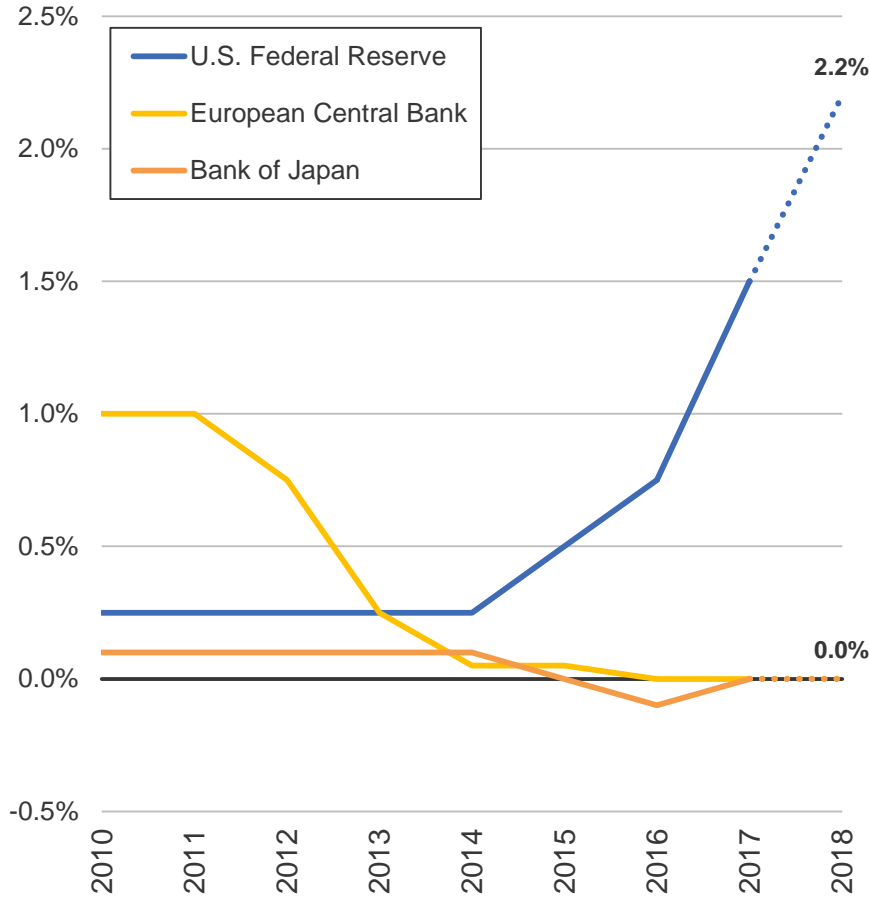


Left source: The National Bureau of Economic Research, as of December 2017.

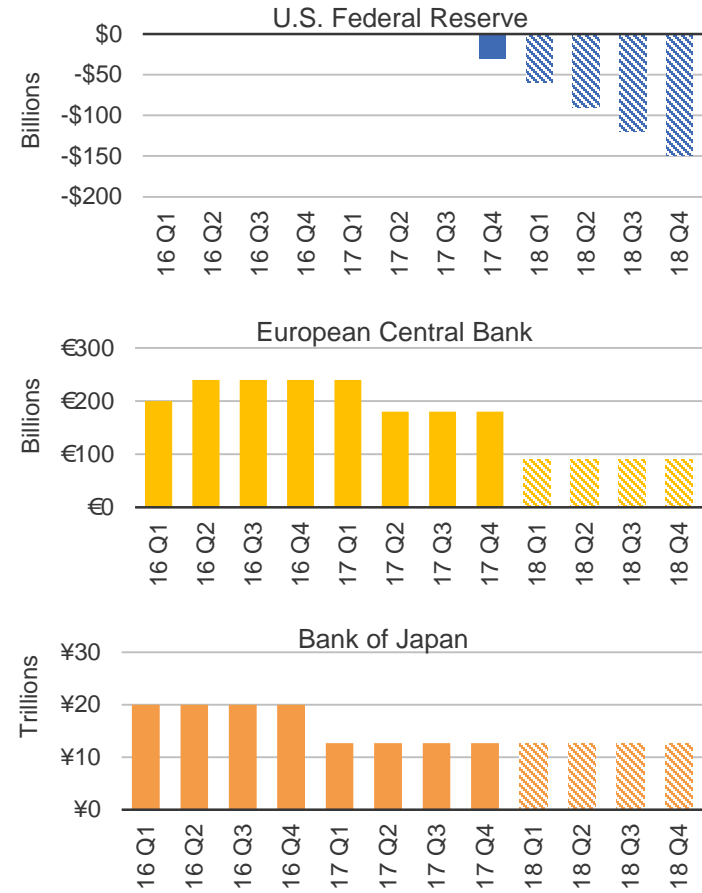


# Global Central Banks Less Accommodative in 2018

## Central Bank Rates Outlook



## Central Bank Net Asset Purchases





# Summary of Our 2018 Outlook

## **ECONOMY**

Above-trend growth across global economies

## **INTEREST RATES**

Rising at a modest pace as inflation remains well behaved

## **CENTRAL BANKS**

Tighter monetary policies globally

## **EQUITIES**

Positive returns buoyed by economic growth, tax reform and relatively low rates

## **FIXED INCOME**

Credit markets continue to outperform interest rate sensitive investments





# What are the Risks to our 2018 Outlook?

## **LESS ACCOMMODATIVE CENTRAL BANKS**

Can the market stand on its own two feet?

## **HIGHER INFLATION**

Central banks could tighten more aggressively  
Triggers economic slowdown and market sell-off

## **DECREASED GLOBAL TRADE**

U.S. trade war with one or more trading partners

## **GEOPOLITICAL RISKS**

Increase in political tension in Asia and/or Middle East

# Questions?



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# Thank You



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